IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

Ex parte THE EQUITABLE TRUST COMPANY OF NEW YORK—Original No. 169.

In the Matter of the Petition of The Equitable Trust Company of New York, as Trustee, for a Writ of Mandamus—Original No. 2757.

In the Matter of the Appeal of The Equitable Trust Company from the Order Issuing the Injunction, dated February 21, 1915.

BRIEF OF SAVINGS UNION BANK AND TRUST COMPANY,

Intervenor and Appellee.

PILLSBURY, MADISON & SUTRO,
Attorneys for Intervenor.

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Since the submission of this case to this Honorable Court for decision, following the extended arguments of counsel, the petitioner and appellant has filed a brief, then a supplemental brief and, up to the present time, a third brief. We therefore feel called upon to file a brief ourselves.

Notwithstanding the voluminous record in this case, counsel for the Trustee have found it necessary or have deemed it proper and advisable to refer to and bring in facts outside of the record and they seek in this extraordinary proceeding to have this Honorable Court decide, without the parties affected being before it, questions of the gravest character involving millions of dollars. They seek to obtain such decisions upon no evidence whatever, other than affidavits, and even upon facts brought to the attention of the Court for the first time in the briefs of counsel. This can truly be called an extraordinary proceeding in this respect, at least. The Savings Union Bank and Trust Company, the Intervenor herein, has valuable rights in connection with these matters which it does not desire to lose, and we respectfully submit that none of the questions which go to the merits of the controversy and which affect the rights of the bondholders of the Western Pacific Railway Company, and none of the many justiciable controversies which appear by these proceedings to be involved, should be adjudicated in a proceeding of this kind, without a trial, but that they should be tried in a *nisi prius* proceeding in a court of equity, with the proper parties before the court, upon proper and competent evidence and according to due process of law.

In the supplemental brief filed by the Trustee is given what purports to be statements of the court below, in connection with several matters which have been presented to that court from time to time for consideration. The proceedings are not given in full

and we have no copies of these records, but upon reading the extracts which counsel have given in their brief it clearly appears to us that the controlling motive of the court below in all of these matters has been to protect the interests of the bondholders of the Western Pacific Railway Company, and we must confess our astonishment that the Equitable Trust Company of New York, whose duty it has been, and is, to protect those interests, should be here complaining of the attitude of the court because it has done and is doing that which it is and always has been the duty of the Trustee to do. The attitude of the court below is well expressed in one of the statements made by the judge and quoted by counsel for the Trustee, as follows:

> "All that I desire to see is that the jurisdiction of this court is exercised in a manner so as to leave no stain on the question of its having protected those whose rights are before it for protection."

Indeed, the principal grievance on the part of the Trustee seems to be due to its fear that the court below will decide that the beneficiaries of the trust, that is to say, the Western Pacific bondholders, are entitled to an equitable lien against the property of the Denver and Rio Grande Railroad Company and that the court may enforce this right, all of which will be against the interests of the holders of the Refunding Bonds and Adjustment Bonds of the Denver Company. The spectacle of a Trustee being opposed to a

court because its attitude is too favorable to the beneficiaries of the trust is indeed unusual.

Is it any wonder that the Trustee is receiving the active cooperation in all of these proceedings, by stipulation and otherwise, of all of the *parties* who are controlled by the Denver and Rio Grande Railroad Company?

Not only does the Trustee object to the actions of the court below but its resentment has gone to the extent of causing it to impugn the ability and integrity of the judge of that court. These attacks have not been confined entirely to the proceedings in court. As an instance of these charges, we call the Court's attention to the following question asked by Mr. Cutcheon during his argument before this Court:

> "Can there be any doubt that a decision announced on the 21st day of February with the implication that it was the purpose of the court to bring these parties in here and to litigate this foreign question was intended to disrupt the plan of reorganization?" (Argument, Cutcheon, p. 183.)

The judge of the court below needs no defender before this Court, and we shall therefore say nothing upon that subject, nor shall we fully express our amazement at this astounding question, with its implication, asked by counsel appearing on behalf of the Trustee, but we submit that people who charge others with acting from improper motives are often guilty of doing those very things themselves, and the charges which they make are intended to divert attention from

their own misdoings, and we submit that the record in this case shows that such is the purpose of the Trustee in these proceedings.

Although the court below is apparently anxious to protect the interests of the bondholders of the Western Pacific Railway Company, who are the beneficiaries of the trust of which the Equitable Trust Company of New York is the Trustee, that Trust Company objects to taking any proceeding in that court to enforce or protect the rights of the bondholders in connection with the equitable lien and is trying in every way to prevent the Denver and Rio Grande Railroad Company being made a party to the foreclosure proceedings. The Trustee also insists upon the right to prosecute the claim of the Western Pacific bondholders against the Denver and Rio Grande Railroad Company, under Contract B, in the United States District Court for the Southern District of New York, and it insists upon that right although it, at the same time, claims that the trustees for the Denver Company's First and Refunding Bonds and Adjustment Bonds can not be made parties to the New York suit without ousting the jurisdiction of that court. The Trustee is therefore insisting upon proceeding with that suit in a court where no judgment of any benefit to the Western Pacific bondholders can possibly be obtained, and where a judgment may be rendered which will deprive those bondholders of all of their rights to have their equitable lien established.

As stated upon the argument in this case, the Savings Union Bank and Trust Company, the Intervenor herein, contends that the Western Pacific bondholders have an equitable lien under the provisions of Contract B against the properties of the Denver and Rio Grande Railroad Company as of June 23, 1905, and that this lien is prior and superior to that of the liens of the holders of the Refunding Bonds of the Denver and Rio Grande Railroad Company, of which there are now outstanding $33,000,000, and of the holders of that company's Adjustment Bonds, of which there are now outstanding $10,000,000. The Intervenor further contends that Contract B and the rights under it were mortgaged and pledged under the First Mortgage of the Western Pacific Railway Company which is sought to be foreclosed by the suit brought in the court below, and that it is not only proper but necessary to have the Denver and Rio Grande Railroad Company and the other subsequent encumbrancers on the property of that company made parties to this foreclosure suit, in order for the Court to protect and enforce the rights of the bondholders, and this Intervenor desires to protect and enforce its rights in this respect in a trial court of equity according to the rules of equity and not in an extraordinary proceeding upon affidavits or upon facts stated in briefs.

That the Trustee is not acting in the interests of the Intervenor with respect to the protection or enforcement of its rights and the rights of the other Western Pacific bondholders appears not only from

what has been heretofore said, but from the record of the Trustee itself in this case.

The Denver Company's Refunding Bonds and Adjustment Bonds were issued through the medium of Blair & Company, Read & Company and Salomon & Company (Exhibit No. 18, p. 9, Exhibit No. 22, p. 193). Blair, Read and Salomon were negotiating for more than nine months prior to March 1, 1915, with the Denver and Rio Grande Railroad Company in connection with its obligations to the Western Pacific bondholders. (Argument, Cutcheon, p. 171, Exhibit No. 21, p. 28). The Trustee, in proceeding to enforce the rights of the Western Pacific bondholders, did not act on its own initiative, but did act at the request of Blair & Company, Read & Company and Salomon & Company, "and others." (Argument, Griswold, p. 138.) The Trustee, after being so requested to institute the litigation, prepared the form of complaint which it subsequently filed in the ancillary dependent suit *before the Bondholders' Protective Committee was even formed* (Cutcheon, Ex. 21, p. 6; Krech, Ex. 21a, p. 11), and afterwards asked Mr. Cutcheon to have the Bondholders' Protective Committee request the Trustee to bring the suit, which request was so obtained. (Cutcheon, Ex. 21, pp. 6, 7.)

Mr. Cutcheon says in his affidavit, dated May 21, 1915, with respect to the prayer contained in the ancillary dependent bill wherein the Equitable Trust Company of New York asked the court to "find and declare the true meaning, construction and effect of

the said Contract B in respect of the provisions that the agreement shall run with the railways of the several companies named therein, and that said provision be enforced as against the Denver and Rio Grande Railroad Company, in accordance with the true meaning and effect thus determined by the court," and to which part of the prayer the Intervenor has called and directed the particular attention of this court (in view of the fact that it calls upon the court where the complaint was filed to decide and determine the entire question of the right of the Western Pacific bondholders to their equitable lien), that *"this prayer was not inserted at the instance of the committee or its counsel"* (p. 21). He does not say at whose instance it was inserted and so far as this record shows we must draw our own deductions as to who these parties were. But inasmuch as the Trustee was not acting on its own initiative but at the request of Messrs. Blair, Read and Salomon, can there be any doubt as to the identity of the parties who are responsible for the insertion of this prayer? Mr. Cutcheon, in his affidavit, after stating that this vital prayer was not inserted at the instance of "the committee or its counsel" states that *"the committee* did not feel that the prayer had any purpose or significance" except to indicate that no rights were being waived! How Mr. Cutcheon felt the record does not disclose.

Mr. Cutcheon further states that prior to the commencement of the suit in New York, he had several conferences with Mr. Murray and with Mr. Gris-

wold, of counsel for the Trustee, "with respect to said bill of complaint and the jurisdiction and manner in which the same should be brought" (p. 7), and that they were also told by the attorney for the Denver and Rio Grande Railroad Company of certain facts which made the bringing of the bill exigent. (Cutcheon, p. 7.) This is the same Mr. Griswold who stated at the hearing of the arguments in these matters that the Western Pacific bondholders had an equitable lien and that the Trustee so contended and had always so contended.

Following these conferences "with respect to the bill of complaint, the jurisdiction and manner in which the suit should be brought," the suit was commenced in the United States District Court for the Southern District of New York, with a prayer that that court construe the meaning of those provisions of Contract B which relate to the equitable lien but without asking that court to find that the Western Pacific bondholders have an equitable lien upon the property of the Denver and Rio Grande Railroad Company as of the date of Contract B and ahead of the liens of that company's Refunding Bonds and Adjustment Bonds, *and without making either of the trustees of the holders of those bonds parties to the suit.*

Mr. Cutcheon's excuse for not making the other trustees parties to that suit is that if this had been done it would have ousted the jurisdiction of that court. (Argument, Cutcheon, p. 187.) But that is no excuse. The suit did not have to be brought at all. Certainly not in that particular court, where

those trustees never can be made parties to the suit, and where no judgment of any value to the Western Pacific bondholders can possibly be obtained and where they stand to lose everything.

Shortly after this suit was brought, Mr. Alvin W. Krech, the president of the Trustee, the Equitable Trust Company of New York, and the present chairman of the Reorganization Committee, filed an affidavit in the court below, in which he said that the Trustee brought said action "in good faith with the intention to proceed with the same and therein to enforce the liability of the Denver Company." And that "neither the mortgage trustee nor the Bondholders' Committee had or has any assurance that the receivers appointed herein would bring such a similar action against the Denver Company or *would prosecute it to an early conclusion,* even if said receivers had the legal right so to do." (Italics ours.) And that "if the Trustee is enjoined from the prosecution of its remedies against the Denver Company there will be great and real danger of a dissipation of the assets of the company," etc. (Krech, Ex. 21a, pp. 14, 15.) And at that same time Mr. Cutcheon filed an affidavit in which he said that the paramount consideration influencing him to advise the Committee to request the Trustee to file a bill, was the *necessity of haste,* to the end that the Trustee might obtain injunctions against prosecutions of certain suits and "so that the obligation of that company under Contract B might be enforced for the benefit of all the depositors with the Committee pro rata." (Cutcheon, p. 16.)

And yet both Mr. Bowie and Mr. Cutcheon stated upon the argument before this Court that this same suit was only brought merely for the purpose of maintaining the *status quo,* and that there is no intention of proceeding with it even at the present time. (Arguments, Bowie, p. 103; Cutcheon, p. 187.)

Here, we submit, is a positive contradiction in respect to the very matter about which counsel were interrogated during their argument by the members of this Honorable Court.

The most remarkable thing in all of these proceedings is that it was not until counsel for the Intervenor during his argument before this Court fully explained the nature of the right of the Western Pacific bondholders to have their equitable lien established and its immense value and great importance to those bondholders, and not until he had criticized the action of the Trustee with respect thereto, that the Trustee, being forced by questions from the Court and from counsel to announce whether it contended that the bondholders of the Western Pacific Railway Company did have or did not have an equitable lien against the property of the Denver and Rio Grande Railroad Company, then for the first time publicly admitted that it did so contend and had always so contended. (Argument, Griswold, p. 138.) Up to that moment, neither the Equitable Trust Company of New York nor the Bondholders' Protective Committee ever informed the Western Pacific bondholders that they had any right to assert such a lien nor that any attempt would be made to protect or enforce

such a lien. On the contrary, the Trustee and the Committee have continually given the Western Pacific bondholders to understand that the rights of the bondholders against the Denver and Rio Grande Railroad Company came behind and were subordinate to the rights of the holders of the First and Refunding Bonds and of the Adjustment Bonds. It may be that the matter was never properly brought to the attention of all of the members of the Committee and that the majority of the members thereof were ignorant of its existence.

In the affidavit of Mr. Cutcheon (Ex. No. 21, p. 9), it is stated, with reference to the fact that the Denver Company net earnings, *after paying* the interest *upon its Refunding Bonds and Adjustment Bonds,* amount to more than one million dollars:

> "If the Denver Company remains a going concern with respectable credit, at least a large part of *this* amount and any increased earnings which it may make, *should be available,* with such earnings as Western Pacific Railway Company may make and as are applicable thereto, to the payment of the interest accruing upon Western Pacific First Mortgage Bonds."

Again,

> "Certain negotiations looking to that end" (the use of the Denver Company's surplus earnings, *after paying the interest on the Refunding Bonds and Adjustment Bonds,* to the interest upon the Western Pacific Bonds) "were had during the winter of 1914-15 between the Denver Company and various bankers, some of them now members of the Protective Committee," etc. (p. 13.)

The Reorganization Agreement, together with the plan and introductory statement (Ex. No. 26), is most significant in this respect. This agreement is signed by the Committee for the bondholders, of which Mr. Alvin W. Krech is Chairman. It may be well in this connection to call the Court's attention to the fact that it appears from the record that Mr. Alvin W. Krech is also the President of the Equitable Trust Company of New York, Trustee for the bondholders, and it would therefore seem that Mr. Krech can not, as Chairman of the Reorganization Committee, properly look after the interests of the bondholders who are parties to that agreement, and at the same time, as President of the Trust Company, look after the interests of the bondholders who are not parties thereto.

As showing that neither the Trustee nor the Committee has ever informed the bondholders of the Western Pacific Railway Company of the existence of the equitable lien which the Trustee now claims that it has ever contended for, we call the Court's attention to the first paragraph of the introductory statement (p. i), where it is said:

> "In order to enable the holders of certificates of deposit * * * and holders of Western Pacific * * * bonds not deposited under said agreement, to judge of the propriety and expediency of the annexed Plan of Reorganization * * * the Protective Committee has thought it best * * * to review in this introductory statement * * * the relations between it" (Western Pacific Railway Company)

"and the Denver and Rio Grande Railroad Company."

Following this, and on page vi of this introductory statement, under the heading, "Purposes and General Considerations," it is stated:

"The financial condition of the Denver Company is such that it has seemed possible that it may become necessary for the Holding Company to take measures to *protect its claim* against the Denver Company, and for that reason provision is made in the plan for the raising of funds, if necessary *to prevent the extinguishment by means of the possible foreclosure of mogtgages* upon the Denver Company's property of the claims to be acquired by the Holding Company. The Adjustment Mortgage of the Denver Company, under which there are outstanding $10,000,000, principal amount, of Adjustment Mortgage Bonds, is now in default (although the interest on these bonds has been regularly paid) by reason of the failure to pay interest upon Western Pacific First Mortgage Bonds, and, should this Adjustment Mortgage be foreclosed, the Refunding Mortgage of the Denver Company securing bonds in the principal amount of more than $33,000,000 (exclusive of about $7,000,000 thereof pledged under the Adjustment Mortgage) may come into default. For the same reason and because of the position that the Western Pacific property occupies in relation to other railway properties and the resulting necessity of protecting its traffic relations, the Protective Committee has deemed it extremely important that power shall exist also to make use of a portion of the proceeds of the $20,000,000 of New Bonds in such manner as may seem to the Reorganization Committee prior to the completion of the reorganization and thereafter to the Board of Directors of the Hold-

ing Company most advantageous in the interest of the reorganization. Accordingly in clause (b) of Article V of the Plan reasonable latitude in the application of a portion of the moneys to be raised has been provided for.

"The necessity of providing for a common agency for the enforcement and protection of the claims against the Denver Company and of raising funds if needed for this purpose is one of the reasons for the formation of the Holding Company." (Italics ours.)

And on page 19 of the Plan, under the heading, "Non-assenting Holders of old Bonds," it is stated:

"Bondholders who shall have withdrawn their bonds from the operation of the Protective Agreement and the holders of Old Bonds who shall not have deposited their bonds under the Protective Agreement or hereunder will not be entitled to participate in the Plan or the benefits thereof to any extent, and will receive *only* their distributive shares of any balance of the *proceeds derived from the sale* of the mortgaged property of the Old Company that may remain after the discharge of obligations and liabilities entitled to prior payment under the terms of the foreclosure decree and orders of Court." (Italics ours.)

There is not one word in the introductory statement, in the Plan, or in the Agreement of Reorganization, from the first paragraph to the last, which suggests the possibility of the Western Pacific bondholders having an equitable lien against the property of the Denver and Rio Grande Railroad Company. On the contrary, the Denver Company's Refunding Bonds and Adjustment Bonds are at all times referred to as encumbrances upon the property of the

Denver and Rio Grande Railroad Company which are superior to and which come ahead of the rights of the Western Pacific bondholders, and, as will be seen from that which is quoted, the Refunding Bonds and the Adjustment Bonds are treated not only as being prior and superior to the bonds of the Western Pacific Railway Company, but as being, on that account, such a menace to the Western Pacific Bondholders that the Committee desires the power to use a material portion of the $20,000,000 new money which is to be obtained through the plan of reorganization, in order to "protect" the rights of the Western Pacific bondholders and "to prevent the extinguishment" of their claims; which means, we assume, that the new money will be used to purchase the Adjustment Bonds. And yet the Trustee now contends, and says that it has always contended, that the Western Pacific bondholders have an equitable lien upon the property of the Denver and Rio Grande Railroad Company ahead of the Refunding Bonds and Adjustment Bonds. We are indeed glad to know that the Trustee does so contend, but we respectfully submit that this Court will look in vain through the entire record of these proceedings to find a single instance where the actions of the Trustee have borne out its present contention, but, on the contrary, the Court will find abundant evidence of the fact that the Trustee has acted at all times in a manner quite at variance therewith.

Why did the Committee undertake to inform the bondholders of all the facts with respect to the relations between the two companies and not only say

nothing about the equitable lien but treat it as not existing?

Furtherfore, we beg to call the Court's attention to the statement made by Mr. Jared How, in his opening argument on behalf of the Trustee, in stating his position, before this Honorable Court. In referring to that part of Contract B, which provides that the obligations thereof shall run with the railways into whosoever hands they may come, Mr. How said:

> "That provision is causing a great deal of trouble,—'shall run with the railways.' I do not envy any man his task to establish that the personal covenant of these railway companies to pay money is a covenant running with the land. * * * If it is a personal covenant and can not be made, even though the assigns be named, to bind the assigns, can it be twisted into what is called an equitable charge, although not intended to be that, anyway?" (Argument, How, p. 27.)

This is certainly a strange statement to be made on behalf of a Trustee who now contends, and who now claims that it has ever contended, that these provisions of Contract B do establish an equitable lien against the property of the Denver and Rio Grande Railroad Company. Let us suppose that Mr. How had appeared on behalf of the Trustee in the ancillary dependent suit in New York, wherein the Court was asked to construe these provisions of Contract B, and that he had made to that Court that same statement with respect to the position of the Trustee in connection with the equitable lien, and that thereupon the

Denver and Rio Grande Railroad Company, on the other side, had stated to that Court that it agreed with Mr. How entirely and that it denied that any such lien exists, would that Court have gone any further? Would not that Court have probably then and there directed that judgment be entered in favor of the Denver and Rio Grande Railroad Company, and would the result not have been that the rights of the Western Pacific bondholders in this respect would have been lost forever?

* * * * *

Counsel for the Trustee now say in their brief that the question of the equitable lien is "a matter of doubt" and they refer to what they say is a "similar covenant" in the case of *Des Moines R. R.* v. *Wabash*, 135 U. S. 576, which was held not to create a lien.

A careful reading of that decision will, we think, convince this Court that the Trustee does not yet appear to be looking for law in favor of the beneficiaries of its trust, and that there is still a remarkable lack of that fidelity and enthusiasm which the bondholders might expect to find in the champion of their rights.

In the case referred to there was a contract covering traffic arrangements between two roads, and it was provided that the "contract and any damages from a breach of the same" should be a continuing lien upon the roads of the two contracting companies, their equipment and income, into whosoever hands they might come, etc. The Court said:

> "It can hardly be supposed that the *conjectural damages* and the *speculative profits* which might yet result to the company from the unperformed part of the contract, through eighteen or twenty years, are to be made a specific lien on the property, attached to it and passing into the hands of whoever might become its purchaser."

But the Court preceded this statement by saying that,

> "If * * **there was a sum of money due, and ascertained or readily ascertainable, this sum might be a lien on the income or property of the delinquent company,"* etc.

It will thus be seen that the Court, while recognizing the propriety of declaring a lien for a sum of money ascertained or readily ascertainable, did not approve of such a lien for "conjectural damages" or "speculative profits." In that case the Court did not discuss the doctrine of equitable liens nor refer to the case of *Ketchum* v. *St. Louis,* 101 U. S. 306, cited by us upon the argument, which decision has been relied upon by the United States Supreme Court in many cases decided after the Des Moines case as establishing the true rule on the subject of equitable liens; nor was there in that case, as here, a provision that the property should be held to be the subject of an express trust. The Des Moines case has never since been approved nor cited by that Court. Moreover, that case would seem to furnish a reason why the plan of the Trustee to obtain a judgment for damages against the Denver and Rio Grande Railroad Company, on account of its failure to perform the obligations un-

der Contract B, as announced by counsel for the Trustee, should not be followed, and to be another ground for the affirmance of the order made by the lower court in this case.

The Western Pacific bondholders may, however, find comfort in the thought that if this Trustee, searching for the law with glasses colored as its apparently are, nevertheless still believes and contends that the equitable lien exists, the bondholders have the most excellent prospects of having this lien finally established and enforced.

During the final argument on behalf of the Trustee much was said to the effect that if the present plan of reorganization should fail it would be detrimental to the interests of the Western Pacific bondholders. In reply to this line of argument we say that the Intervenor of course recognizes the right of every bondholder to enter into such arrangements as his interests may dictate and it has no desire to, nor will it, interfere therewith, except insofar as it may be necessary to do for the protection of the rights of itself and of those whom it represents. The Intervenor does not believe, however, that there is much in the calamity arguments which are being made on behalf of the Trustee. If the reorganization plan should fail, as a result of the Court's taking the proper steps to protect and enforce the rights of the bondholders, and the bondholders should then become the owners of this entire road, free and clear of encumbrance, and free to make such arrangements with the Denver and Rio Grande Railroad as they saw fit, and with

all of their rights against the latter company being protected and enforced, can there be any question that the rights of the bondholders under those conditions would be infinitely greater and more valuable than shares of preferred and common stock in a company which will have a present mortgage debt of $20,000,000, capable of being increased to $50,000,000, and where a large portion of the proceeds of the sale of the bonds now to be issued under this mortgage are to be used to purchase the Adjustment Bonds of the Denver and Rio Grande Railroad Company? The Western Pacific Railway is in a better condition today than it ever has been in its history and is now earning over $1,500,000 annually in excess of the cost of operation. There is no necessity for sacrificing the interests of the bondholders and we submit that the threatened calamity does not impend.

Respectfully submitted,

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